The Value of Job Loss Payment Protection Programs

Introduction

Payment protection programs like credit insurance and debt protection are facing unprecedented scrutiny from consumer advocates and regulators. Some question the value these programs provide and some even go so far as to claim the programs may be financially detrimental to consumers. Inherent in most opposition is an articulated desire to protect consumers from unnecessary fees and economic strain. If this is the case, these groups should take the time to more closely evaluate the meaningful benefits these programs provide to consumers, particularly in the current economic environment.

Credit insurance and debt protection programs are designed to provide a 'bridge over troubled water' or safety-net for borrowers should the unexpected occur – loss of life, sickness or injury, job loss, or other unforeseen events. These programs help cancel or suspend debt, make monthly payments or pay off the loan, keeping borrowers current with their loan payments, reducing their delinquencies and foreclosures, and ensuring they have one less thing to worry about during a time typically fraught with emotional and economic stress. In 2009, over $2 billion in benefits were paid from credit insurance programs alone.[1] This paper focuses in particular on the value of the job loss benefit currently offered in many payment protection programs.

Consumers' Unemployment Concern is on the Rise

"Tens of millions of once-secure middle class families now live paycheck to paycheck, watching as their debts pile up and worrying about whether a pink slip or a bad diagnosis will send them hurtling over an economic cliff." Elizabeth Warren[2]

The economic security of American households has eroded in the last decade. Many low to middle-income households have experienced a growing gap between their incomes and their day-to-day costs of living, resulting in decreased savings, rising levels of debt, and widespread economic instability. Since the year 2000, many households have attempted to cope with this financial imbalance by relying on credit cards to cover basic expenses not met by their earnings. In addition, cashed-out home equity - $1.2 trillion over the last six years – was used to pay down those debts and cover other costs of living, creating a situation of financial fragility for many consumers.[3] According to a recent Harris Poll, 27% of Americans have no personal savings at all, and 34% of Americans have no retirement savings.[4]

In this environment, unemployment concerns loom large in the minds of most consumers. With unemployment rates 50% higher than those in 2008, Americans are expressing record-levels of concern about the stability of their jobs and income. According to a recent Gallup poll[5], 39% of Americans view unemployment as the single most important problem facing the country today, with the 'economy in general' ranking second. Overall, some type of economic concern – from unemployment to the budget deficit – is cited as a primary concern by more than 76% of the respondents.

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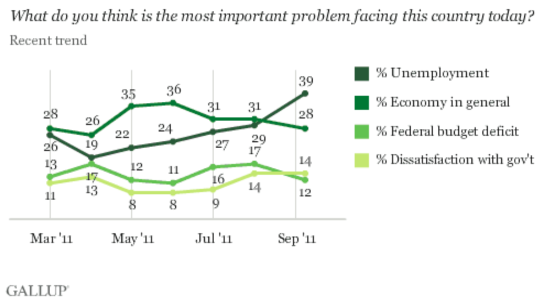
[1] 2009 Credit Insurance Experience Exhibit

[2] Warren, E. (December 2, 2009) *The Huffington Post*, "America Without a Middle Class". (Retrieved from www.huffingtonpost.com)

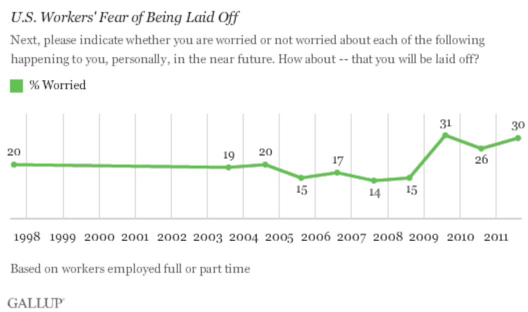
[3] Garcia, Jose. (November 2007) *Dēmos.com,* "Borrowing to make ends meet – the rapid growth of credit card debt in America" (retrieved from www.demos.com)

[4] Taylor, Humphrey (February 2, 2011) *The Harris Poll #13,* "Number of Americans Reporting No Personal or Retirement Savings Rises" (Retrieved from www.prnewswire.com)

[5] Gallup Poll (August 2011) *Gallup*," Work and Education Poll"



For those who currently have jobs, concern is rising over the possibility of unemployment or a reduction in benefits or pay, with 30% of Americans indicating a fear of being laid off.



The concern is highest among those with low to moderate incomes, arguably those most vulnerable to a financial setback.

U.S. Workers' Job-Related Concerns -- by Household Income

	Less than $50,000	$50,000 to $74,999	$75,000 or more
	%	%	%
That your benefits will be reduced	50	41	39
That your wages will be reduced	40	23	28
That your hours at work will be cut back	38	33	19
That you will be laid off	39	32	18
That your company will move jobs to countries overseas	18	5	9

Aug. 11-14, 2011; based on workers employed full or part time

GALLUP

A 2010 MetLife study paints a similarly bleak picture of Americans' current state of mind. According to the study, 65% of Americans are concerned about job loss. Those concerns appear valid, as the study also found that if they were to lose their job, 65% said they could meet their financial obligations for less than three months. Almost two in ten (19%) could meet them for only two weeks or less. Even those making $100,000 per year or more are not immune, with more than one-quarter (29%) saying they could not meet their financial obligations for more than one month following a job loss. Most of those surveyed (61%) are also concerned about losing their home in the event of a job loss, and 56% are concerned about going into bankruptcy in the event of a job loss.[6]

[6] MetLife (April 2010) "MetLife Study of the American Dream: An Uphill Climb"

Financial Impact of Unemployment

Unemployment is the leading cause of foreclosures in America, according to a recent New York Times article.[7] And while the rate of homes falling into foreclosure appears to have slowed, the cause is delays in processing the foreclosures, rather than a true housing recovery.

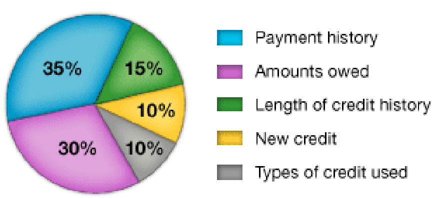
If consumers are fortunate enough to avoid foreclosure or bankruptcy, there is still reason to be concerned about maintaining their monthly payments. Failure to do so can lead to late fees and higher interest rates, which add to existing debt and negatively influence credit scores.

A credit score is a numerical expression of the data contained in an individual's credit report, and provides a tool for measuring an individual's creditworthiness, in addition to income history and employment status. Originally developed by the Fair Isaac Corporation in the 1960's, the FICO score is the best known and most widely used credit score model in the United States.

While a falling credit score is certainly preferable to foreclosure or bankruptcy, it can still have a significant impact on consumers. The FICO scoring scale is between 300 and 850. More than one in four Americans now have a credit score below 600, which is considered low. Statistics released from FICO Inc. show that 25.5% of the 170 million Americans with active credit accounts have scores of 599 or below, based on data from April 2010 consumer credit reports. The data also showed that 2.4 million more people have fallen into the lowest score categories in the past two years.[8]

Late payments, collection accounts, settled accounts, repossessions, foreclosures, and public record items (tax liens, judgments, bankruptcies) can negatively influence a credit score. Even minor late payments, such as 30-day delinquencies, can have an impact, as an individual's payment history makes up the largest part of the score.

Credit Score Factors



An unforeseen unemployment could easily cause consumers to become delinquent on a payment or miss one or more altogether, causing a negative item to appear on their credit report and damaging their credit score. Even if a consumer is able to get back to work quickly, negative items will typically remain on a credit report for at least 7 years.

Why is this important? Access to credit and cost of credit are the two primary reasons why credit scores matter. Particularly in a contracting lending climate, if a score is too low, the applicant may not qualify for a loan. Even if the applicant does qualify, the cost of credit could vary greatly depending upon the credit score.

For example, for a 30-year fixed rate mortgage of $185,000, the difference in the APR, monthly payment, and total interest paid over the life of the loan are as follows:

7 Martin, Andrew. (June 4, 2011) *NewYorkTimes.com,* "For the Jobless, Little U.S. Help on Foreclosure" (Retrieved from www.newyorktimes.com)

8 York, Kate. (July 25, 2010) *News and Sentinel*, "Average FICO Score Drops Below 600" (Retrieved from newsandsentinel.com)

FICO Score	APR	Monthly Payment	Total Interest Paid
760-850	3.976%	$ 881	$ 132,038
700-759	4.198%	$ 904	$ 140,608
680-699	4.375%	$ 924	$ 147,524
660-679	4.589%	$ 947	$ 155,983
640-659	5.019%	$ 995	$ 173,297
620-639	5.565%	$ 1,058	$ 195,868

Those with higher scores will obtain the lowest interest rates, resulting in lower monthly payments. The difference in total interest over the life of the loan for a customer in the highest score bracket versus the lowest is $63,830.

A credit score is also used for evaluating an individual beyond the world of lending. A consumer with bad credit may pay 20% to 50% more in auto insurance premiums than a person with good credit.[9] The credit score also may influence utility deposits, apartment lease applications, and employer hiring decisions.[10] Jobless Americans who may have a poor credit score resulting from unemployment, may be unpleasantly surprised to find their score will be used against them as they are searching for new employment and possibly even prevent them from obtaining a new job.

Unemployment Assistance Programs Fall Short

When faced with a job loss, state unemployment benefits may be the primary source of financial assistance for many consumers. These benefits were not intended to replace a worker's full salary, but rather to serve as temporary financial assistance for the unemployed. With state weekly unemployment benefits averaging around $300, many Americans would find themselves in financial difficulty rather quickly if they were relying on these benefits alone.

The Federal government has made attempts to address the issue of delinquency and foreclosure for homeowners, but they have fallen short in connection with the unemployed. At the start of 2009, the Administration announced its primary foreclosure prevention initiative, the Home Affordable Modification Program, which provides incentives to banks to modify mortgages, reducing monthly payments for eligible homeowners. The Administration said the Program would help three to four million homeowners, but so far, only 670,000 homeowners have received permanent modifications. In addition, the Program was intended for homeowners with 'risky' mortgages and jobless homeowners are often ineligible because some payment, even if reduced, is required. With unemployment currently being the primary cause of foreclosures, there is a disconnect between the Homeowner Program's design and the Nation's economic realities. [11]

As the problems created by unemployment and housing persist, the Administration faces even greater challenges. "So far, I think the public record will show that programs to help unemployed homeowners have not been very successful," said Jeffrey C. Fuhrer, an executive vice president of the Federal Reserve Bank of Boston. Morris A. Davis, a former Federal Reserve economist, estimates that as many as a million homeowners slipped into foreclosure because of insufficient help for the unemployed.

According to The New York Times article, many unemployed or underemployed homeowners would welcome an extended break in mortgage payments, and two real examples were provided. Mary Ernest, 51, of Blackstone, Massachusetts, lost her job as a school aide and said she has been "reduced to begging, more or less," to keep her home. Adam Heyman, 41, of Chelsea, Massachusetts, was able to make the mortgage payments on his condominium for about 18 months, but then fell behind. Although he did eventually obtain another full-time job, his bank had already foreclosed on his home. "If I had a way to

[9] *BankRate.com* report (April 1, 2005), "How Credit Scores Affect Insurance Costs" (Retrieved from www.bankrate.com)
[10] *Federal Reserve Bank of Atlanta* (2008), "New FICO Model Changes Approach to Consumer Credit" (Retrieved from www.frbatlanta.org)
[11] Martin, Andrew (June 4, 2011) *NewYorkTimes.com* "For the Jobless, Little U.S. Help on Foreclosure" (Retrieved from www.newyorktimes.com)

slow down the process or stop it for a while, that would have been nice," Mr. Heyman said, adding, "Now I can certainly afford to pay."

Government assistance to the unemployed in any form is not guaranteed and is politically controversial, with Republicans seeking to trim the budget on the side of reducing or eliminating assistance altogether, and Democrats suggesting a variety of ideas that do not adequately meet the needs of the unemployed borrowers.[12] Unfortunately, while the debate rages on in Washington, consumers will continue to struggle.

Payment Protection Benefits Provide Critical Help

"Combine rising unemployment levels with invisible savings rates and you have a sure formula for financial disaster. Just think how many homes could be saved if people had the equivalent of six mortgage payments in a savings account? Combine savings with unemployment and many households might avoid foreclosure for months. In fact, if they can find new jobs, savers in many cases are able to avoid delinquencies and foreclosure altogether. Jim Saccacio, Chairman and CEO, RealtyTrac.com [13]

In theory, maintaining adequate savings to guard against unexpected financial difficulties is a sound strategy for consumers. But as the MetLife study revealed, 65% of Americans could not meet their financial obligations three months after losing their job, and 19% could meet them for only two weeks or less. [14]And the Harris Poll revealed 27% of Americans have no personal savings at all.[15] The unfortunate reality is, for most consumers, adequate savings just aren't there.

So what are consumers to do? What resources are available for those looking to protect themselves against unforeseen unemployment? For many consumers, payment protection programs like debt protection and credit insurance are currently one of the only options for them. Private job loss protection is not available from traditional insurance agents, but is included as a benefit in most debt protection and some credit insurance programs.

Debt protection is not insurance, but a lending program provided through financial institutions to their loan customers for credit cards, real estate, and other consumer loans. An amendment to the lending agreement is made in which the borrower agrees to pay a fee in exchange for the lender canceling or suspending some or all of their debt upon the occurrence of one or more specified events, typically death, disability and/or job loss. The fee for the protection is included in the borrower's monthly loan payment.

As is the case with traditional insurance, debt protection programs generally include some waiting periods and exclusions to protect against anti-selection. For job loss benefits, these may be a vesting period (30, 60, 90 days) during which no benefits would be provided, and exclusions like an unemployment that doesn't qualify for state unemployment benefits. Monthly or aggregate benefits are also typically capped to stated maximums. Debt protection job loss benefits are most often part of an overall package of benefits, but may be offered on a stand-alone basis.

If the borrower qualifies for job loss benefits, his or her monthly payment will be cancelled or suspended (depending upon the coverage offered) for the prescribed time period, typically 3-12 months. For a borrower with a $750 monthly home equity loan payment and/or a $350 monthly car payment these benefits can be significant, and could mean the difference between surviving the unemployment and damaging a credit rating, losing an asset(s), or filing for bankruptcy.

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12 *Hudhouses.com* (June 29, 2011) "Foreclosures and the Unemployed". (Retrieved from www.hudhouses.com)

13 Miller, P. *HomeFinder.com*, "Unemployment and Foreclosure - Connecting the Dots". (Retrieved from www.homefinder.com)

14 MetLife (April 2010) "MetLife Study of the American Dream: An Uphill Climb"

15 Taylor, Humphrey (February 2, 2011) *The Harris Poll #13*, "Number of Americans Reporting No Personal or Retirement Savings Rises". (Retrieved from www.prnewswire.com)

Consumers Value Payment Protection Programs

A number of studies have been conducted over the years testing consumer satisfaction with credit insurance, with favorable results. A survey of consumer attitudes reported by the Federal Reserve Board affirms historically high satisfaction among those who purchase credit insurance and concludes that credit insurance purchasers believe they would be ill-served by any move to restrict credit insurance as an option when they borrow.

The Survey Research Center of the University of Michigan surveyed 1,006 consumers during September and October 2001 for the Credit Research Center of the McDonough School of Business of Georgetown University using a questionnaire designed by Thomas A. Durkin, Senior Economist, Board of Governors of the Federal Reserve System (FRB), and a member of the FRB's Division of Research and Statistics.

The survey confirmed findings of earlier surveys, with up to 90% of credit insurance purchasers responding that they are satisfied with credit insurance and would purchase it again when borrowing, and shows again that consumers receive ample notice that credit insurance is a voluntary option to insure loans when they borrow.

Results and analysis of the survey are reported in an article by Mr. Durkin entitled, "Consumers and Credit Disclosures: Credit Cards and Credit Insurance" 16 that also examines a survey conducted during 2001 concerning consumer attitudes about the use of credit cards and credit disclosures under the FRB's Reg Z governing Truth in Lending.

Concerning credit insurance, Mr. Durkin concluded, "With respect to credit insurance because the views of users and nonusers seem so divergent, it seems important that the views of users be given sufficient weight in considering public policies in this area. According to the views expressed by many users of credit insurance, eliminating this product by regulation could be disadvantageous to them."

The study confirmed the findings of every study conducted during the past 30 years in which consumer knowledge and attitudes about credit insurance have been tested. Uniformly the studies find that consumers value credit insurance, understand it, received ample notice that selection is voluntary, and said they would purchase this valuable financial protection again when they borrow.

His analysis noted that the willingness of consumers who use credit insurance to purchase it again when borrowing "seems to indicate that they feel considerably better about the product than its critics." A clear majority in all three categories said they would purchase credit insurance again when borrowing, including 94% of installment borrowers, almost 78% of equity borrowers, and 71% of first mortgage insurers.

Previous landmark surveys and studies of consumer attitudes to credit insurance include a 1973 study by the Ohio University College of Business Administration, 1977 and 1978 surveys for the Board of Governors of the FRB, a 1986 study for the Federal Reserve Bank of San Francisco, and a 1993 study by Purdue University.

Although an industry-wide study has not yet been conducted for debt cancellation or debt suspension agreements, financial institutions often conduct their own surveys specific to their programs, which yield similarly positive results. Since 2005, one large regional bank has been surveying its debt cancellation customers and asks the following questions (with the corresponding results through August 2010):

How important was the benefit to you and your customers financially?

Critically important (wouldn't have gotten by without it) 67.6%
Important (would have gotten by without it,

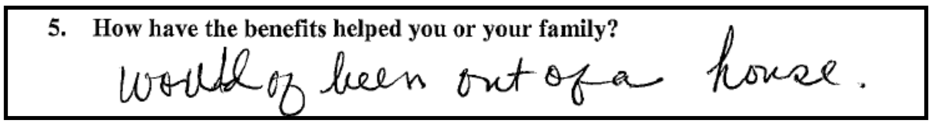
[16] Durkin, Thomas A. (2002) *Federal Reserve Bulletin*, "Consumers and Credit Disclosures: Credit Cards and Credit Insurance"

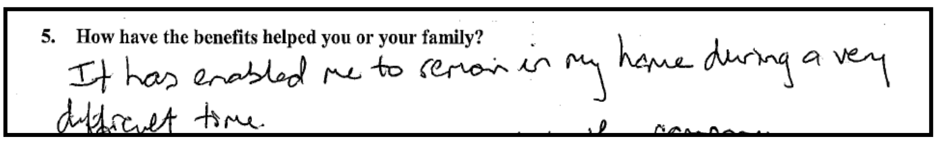
but it would have been difficult) 29.7%
Not important (would have been okay with or without it) 2.7%

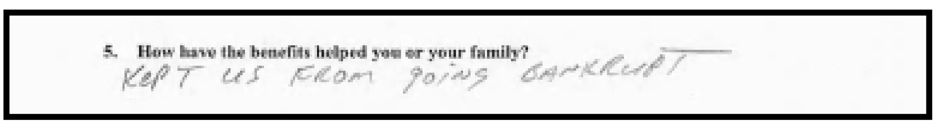
How valuable was the benefit to you in relation to the monthly fee paid for the product?

Very	91.9%
Somewhat	5.4%
Not at all	2.7%

The survey also asks for feedback on how the benefits have helped the customers and their families. Below are some of the actual responses the bank received, which are typical of the majority of responses received:


5. How have the benefits helped you or your family?
Would of been out of a house.


5. How have the benefits helped you or your family?
It has enabled me to remain in my home during a very difficult time.


5. How have the benefits helped you or your family?
KEPT US FROM going BANKRUPT

What would have happened to these customers had they not purchased the bank's payment protection program? What would the groups and individuals who oppose the concept of payment protection say to these people about the decision they made to include the protection in their loans? In 2009, over $2 billion in benefits were paid from credit insurance programs. [17]While there is currently no single source of data for debt protection programs, the benefits they provide would likely increase that number significantly. Where would the recipients of those billions of dollars in benefits have turned for help had they not received them?

Summary

In study after study, consumers have expressed a high level of satisfaction with credit insurance and debt protection programs. Now more than ever, consumers are experiencing financial concerns such as increasing debt and medical costs, lower home values and savings, and job insecurity. Many consumers have no insurance at all, and even more still are underinsured. These factors combined create an environment in which the benefits provided by credit insurance and debt protection programs may be more vital than ever; and one in which the bias against these programs from some organizations and individuals is perplexing.

Traditional insurance and a robust savings strategy are sound options for many people, and are the options those who oppose payment protection plans most often recommend. But job loss protection is not available in traditional channels, and the data suggests that many consumers, particularly those in middle to lower income brackets, are not saving likely because they are already struggling daily to make ends meet. Payment protection programs may not be the perfect solution for every consumer, but they are an

[17] NAIC, "2009 Credit Insurance Experience Exhibit" (Retrieved from www.naic.org/store_pub_statistical.htm#credit_insurance_report)

ideal solution for many. Before drawing a speedy, uninformed conclusion about the value these programs provide, it would be advisable to take a deeper look at the economic realities most Americans are currently facing, and the real and meaningful difference payment protection benefits can make to consumers in a time of need.

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